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SUBJECT: TEXTILES AND APPAREL SECTOR: UPDATED STATISTICS AND
PROJECTIONS OF FUTURE COMPETITIVENESS - SRI LANKA

Ref: (A) State 138090 (B) Colombo 537 (C) Colombo 533

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1. Summary: Textile and apparel export growth has slowed following the expiration of the Multifiber Agreement (MFA). The decelerating growth suggests that the apparel industry will no longer be the main driver of Sri Lanka's economic development. Large scale operators who have invested in new technology and backward integration continue to perform well. Contrary to earlier expectations of massive job losses due to the expiry of the MFA, the industry is reporting a serious shortage of labor. End Summary.

2. The following are the statistics requested in Ref A regarding Sri Lanka's textiles and apparel sector. Source is the Central Bank of Sri Lanka except as noted:

	2005	2006
Jan-June		
Total industrial production:		
(Millions of USD)	7,784	NA
Total textile/apparel/leather production:		
(Millions of USD)	3,071	NA
Textile/apparel exports:		
(Millions of USD)	2,895	1380
Textile/apparel share of total exports:		
(Percent)	45.6	43.6
Textile and apparel share of total imports:		
(Percent)	17.2	14.7
Textile and apparel exports to the US:(a)		
(Millions of USD)	1,679	845
Total manufacturing employment:		
(Thousands)	1,385	NA
Total textile and apparel employment	NA	NA

(a) based on USITC data

3. Recent growth: Textile and apparel export growth has slowed following the expiry of the MFA. Textile and apparel exports

increased by about 3 percent in CY 2005 and 4 percent in the first half of 2006, compared to 9 percent growth in 2004 and 6 percent in 2003. While Sri Lanka's Treasury Secretary recently told a meeting of Sri Lanka Garment Buying Offices Association that the "apparel industry is the future of Sri Lanka," the decelerating growth suggests that the apparel industry will not be in a position to provide the main impetus for Sri Lanka's future economic development. While there is no detailed information on the financial stability of the sector, news of cash flow problems faced by small and medium sized operators is emerging in private discussions. Large scale operators who have invested in new technology and backward integration continue to perform well.

13. Prices: The key problem faced by apparel manufacturers is the acute pressure on prices, which have fallen sharply. However, some export categories, such as lingerie, have received higher prices and continue to enjoy substantial margins.

14. Impact of the US and EU restrictions on China: Sri Lanka has benefited from US restrictions on China. Sri Lanka's exports to US of the restricted categories have risen sharply while exports of unrestricted categories have recorded substantial declines. The industry fears that the period beyond 2007 will pose several risks to the industry due to the entry of Vietnam to the WTO and the expiry of China trade restrictions in 2008.

15. Imports from China: All textile fabric imports are free of import duty to support the apparel industry. There is a 15 percent import duty and an additional 15 percent tax on apparel. There are no specific restrictions on imports from China.

16. Impact on labor: An estimated 10,000 to 30,000 employees have lost jobs due to closure or contraction of operations of some factories. However most of these workers are believed to have been

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absorbed back into the industry. In fact, there are about 30,000 vacancies in the industry as of September 2006. According to industry sources, many large factories are working below capacity due to labor shortages. The shortage is attributed to lack of accommodation and transport facilities, poor perception of factory workers in rural areas, migration of Sri Lankan workers to jobs abroad, the demanding nature of factory jobs, and the rising cost of living without a commensurate increase in salaries.

17. In 2005, the apparel industry requested a six-month deferment of a Government mandated wage increase to private sector employees. The government acceded to the request delaying the application of the wage increase by six months from August 1, 2005 to January 1, 2006 for apparel workers. The apparel industry has protested against a recent move by some trade unions to request a minimum wage of Rs 10,000 (USD 100) for private sector employees. Garment producers contend that wage demands should be tempered by the realities facing the industry.

Action to improve competitiveness

18. A new apparel industry strategy - Sri Lanka's apparel industry has begun to review its 5 year apparel industry strategy 2003-2007 due to the slowdown in export growth from an anticipated 12 percent to about 3.5 percent in 2005-2006. The industry has not established new targets for export growth but has decided on a set of "strategic initiatives" for the next 3-year period. The initiatives include image branding, improving design and development capability, increasing productivity, human resource development and worker welfare, and supply chain management to improve lead times. The industry also plans to request that the government provide fiscal incentives (tax exemptions), assistance to build worker housing, and a moratorium on electricity rate hikes applicable to the industry.

19. Backward integration - The garment manufacturers are taking steps to improve backward integration. Numerous production facilities for accessories, textile mills, dying, washing and finishing plants have been or are being set up. Recently, a large apparel company began building a dedicated apparel and textile

complex with the aim of inviting fabric and accessory manufacturers from around the world. There are various efforts to improve skills and training, including a tie up with North Carolina State University. As part of the US government's tsunami reconstruction program, USAID will construct and equip two model vocational training centers to provide training for the apparel industry.

¶10. Image building - The industry has launched an international image building campaign based on a new Sri Lankan brand "Sri Lanka Apparel: Garments without Guilt". The campaign strives to differentiate Sri Lanka as an ethical sourcing destination based on good working conditions in factories and broad compliance with International Labor Organization standards, including the absence of child labor in the apparel industry.

¶11. Preference schemes - Sri Lanka qualified for EU GSP+ benefits from July 1, 2005, allowing Sri Lankan textile and apparel duty-free entry to the EU. However, Sri Lanka is not able to reap full benefits of the program due to the requirement of local value addition in excess of 50 percent. Sri Lanka is negotiating to reduce the required value addition to 35 percent, although certain segments of the apparel industry, especially those that have recently invested in backward integration, oppose the change.

¶12. Prospects: Sri Lanka's apparel industry is at a cross roads. The industry (especially the large players) has reached a high level of sophistication in the production process. However, the industry needs to become a full service destination, providing services from the design stage to production. In this environment, large players that have upgraded production and technology, invested in backward integration, formed ties with foreign buyers and secured access to finance will continue to perform well. Smaller players face difficulties due to lack of financing, lagging technology, high electricity costs, serious labor shortages, and competition from low cost countries.

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